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## Economics focus

### A saving grace

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#### Japanese households have lost their appetite for thrift

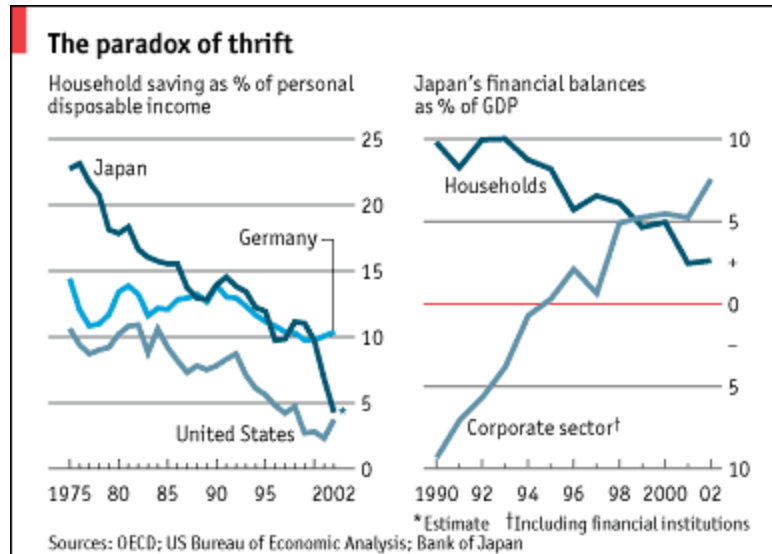
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THE profligacy of American households is legendary: their eagerness to spend and spend has been the main motor of the American economy in recent years. The Japanese, in contrast, are renowned for their thrift. It is often claimed that one reason for the country's economic stagnation is that consumers, fearful of deflation and unemployment, insist on keeping their wallets firmly shut. Yet it is a myth. Although in the early 1980s Japanese households were among the world's champion savers, they are so no longer. Indeed, their saving rate is now roughly the same as that of spendthrift Americans.

Recently revised figures show that Japanese household saving fell from 23% of personal disposable income in 1975 to 14% in 1990, and then to 6.9% in 2001 (the latest official figure). Osamu Tanaka, an economist at Morgan Stanley, thinks the ratio fell to 4% last year and to a piffling 2% in the first quarter of 2003. If so, Japan's household saving rate is now below America's (at present 3.5%) for the first time in 50 years. It is also well below rates in the euro area, which are typically above 10%.

Thanks to the decline in saving, Japanese consumer spending has outpaced the growth in incomes. Over the past couple of years it has continued to rise even as incomes have shrunk. Such a sharp fall in saving seems puzzling: a popular argument has it that deflation causes people to put off buying things in the expectation that they will be able to get them more cheaply next year. In addition, Japanese households have suffered from a slump in asset prices, and thus a loss of wealth. So they should be saving more to rebuild their nesteggs. And there is a third reason why you might have expected higher, not lower, household saving in Japan: the big increase in government borrowing in the past decade. According to a theory known as Ricardian equivalence, households should now be anticipating higher future taxes to repay the extra government debt, by saving more today. Yet ordinary Japanese are saving less.

Why? Perhaps the best explanation for the fall in saving over the past two decades lies in a theory called the life-cycle hypothesis. This supposes that during their working years individuals spend less than they earn, and thus accumulate wealth, which they plan to draw on once they retire. So the more retired people there are in relation to the number of workers, the lower the saving rate will be. The ratio of Japanese aged over 65 to those of working age rose from 15% in 1980 to 28% in 2000. It is forecast to increase to 38% by 2010 and to 50% by 2020.



A study by Peter Morgan, an economist at HSBC, finds that this demographic shift can explain half of the fall in Japan's saving rate over the 20 years to 2000. Much of the rest of the decline may be related to inflation. When inflation soared in the 1970s, the erosion of the real value of wealth prompted households to save more to rebuild their assets. As inflation fell, they needed to save less to maintain their real wealth.

But neither demographic change nor inflation can explain the steep fall in the saving rate since 2000. One possible cause, suggests Mr Morgan, is the maturing in 2001 of a lot of high-yielding, ten-year postal savings deposits. As households replaced these with assets yielding lower returns, their interest income fell. If they save largely out of investment income and consume largely out of their wages, this could reduce the saving rate.

Another clue is that most of the fall in the saving rate is accounted for by those over 60. The elderly, who often have fixed incomes, no debts and hold their wealth mainly in bank accounts, are the one group with nothing to lose from deflation. Their money goes further, so they spend more.

## Starving the piggy bank

The recent plunge in the saving rate could be reversed over the next few years, but the long-term trend is surely downwards, because Japan's population will continue to age. Mr Morgan reckons that the saving rate could drop by another five percentage points from its 2001 level, to 1.7% by 2010. In contrast, many economists forecast that over the next few years America's saving rate will rise to at least 6% as consumers are forced to trim their debts.

Japan's high rate of saving used to be the main reason for its large current-account surplus. (The current-account balance is equal to the gap between domestic saving and investment.) So if Japanese households continue to save less, will Japan's current account move into deficit? Not necessarily. That depends on total national saving—ie, saving by companies and the government as well as households.

In recent years the government's hefty borrowing has contributed to a fall in national saving. However, the behaviour of households and government has been offset by a marked increase in saving by firms. The corporate sector is running a big financial surplus, because firms have slashed investment and started to repay debts. Non-financial companies and financial institutions together ran a surplus of 8% of GDP last year (see right-hand chart). In 1990 they were net borrowers to the tune of 9% of GDP. As a result, Japan's total national saving has stayed high relative to investment, keeping the current account in surplus.

But what if business investment rebounds? Would the current-account surplus then vanish? The answer is not a simple Yes, because changes in the financial balance of one sector can cause offsetting shifts elsewhere. For instance, the fall in borrowing by firms in the recent past has helped to push down interest rates; lower interest

income has then reduced household saving. When companies begin to borrow again, interest rates will rise, possibly boosting household saving. Moreover, once firms have finished cutting costs and reducing debts, there will be less need for a large budget deficit to support demand. A stronger economy would lift government revenues, narrowing the deficit. So total national saving might not shrink much. It could be premature to say *sayonara* to Japan's current-account surplus.

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